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Expert Report of Paul A. Marcus

September 19, 2007

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Introduction

1. I have been retained by Fried, Frank, Harris, Shriver & Jacobson LLP, counsel for Magten Asset Management Corporation ("Magten") on behalf of both Magten and Law Debenture Trust Company of New York to analyze and assess the impact of misstatements and omissions in NorthWestern Corporation's ("NorthWestern" or "Company") financial statements and public disclosures during 2002 on NorthWestern's invested capital and the availability of additional capital.

2. I have prepared this report to set forth the opinions I may express at the trial of this matter and reserve the right to supplement this report based upon information that may become available subsequent to the date of this report. When I testify at trial, I may illustrate my testimony with demonstrative aids such as graphs, charts and/or slides.

3. My opinions are based upon an independent examination of the evidence provided by the parties in this case and my knowledge and professional experience. I express all opinions to a reasonable degree of professional certainty.

4. The general categories of information that I have reviewed during the course of my analysis to assist in formulating my opinion include:

- Case related documents in the Magten Asset Management Corporation & Law Debenture Trust Company of New York v. NorthWestern Corporation litigation including but not limited to:
  - Case complaint
  - Depositions and related exhibits
  - Board meeting minutes
  - Presentations to rating agencies
  - Bear Stearns presentations to NorthWestern
  - Management Financial and Information Reports
  - E-mails
  - Company memos
  - Company financial projections
- NorthWestern's Securities and Exchange Commission ("SEC") filings and press releases
- SEC complaints and proceedings involving NorthWestern and its former management

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- Equity research for NorthWestern and the utility industry
- Rating agency press releases and reports
- Credit facility agreements
- Other research related to NorthWestern and the utility industry

5. I have also relied on the analyses and findings of Robert Berliner in his Expert Report dated September 19, 2002 related to NorthWestern's violations of U.S. generally accepted accounting principles ("GAAP") and SEC disclosure regulations and the impact of those violations on NorthWestern's financial statements and financial covenants.

6. A complete list of documents I considered to formulate my opinions in this matter is provided in Exhibit 1.

Qualifications

7. I am a professional with over twenty years of experience in corporate finance, mergers and acquisitions, valuation, financial analysis, and advising on complex financial transactions. I hold an M.B.A. from the University of Chicago and a B.S. from Tufts University. I also hold the Chartered Financial Analyst designation granted by the CFA Institute and successfully completed a formal credit training program at Bank of America.

8. As a practitioner, I have substantial experience in performing financial analysis related to providing capital to companies as well as advising them on financing strategy. In my roles at Bank of America, Shawmut Bank and Marlborough Capital Advisors, I was responsible for recommending investment of senior debt, subordinated debt, and equity in excess of a billion dollars. As an investment banker, I assisted companies in determining the appropriate capital structure and financing plans to achieve their goals and advised them in transactions which raised funds from equity and debt sources including but not limited to: the public equity markets, private equity and mezzanine funds, insurance companies, finance companies, commercial banks (cash flow and asset-based loans), factors, and others. These investments covered a wide variety of

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industries including electric utilities, gas utilities, gas pipelines, independent power producers, and others.

9. As a consultant, I have provided consulting and expert services to numerous attorneys and companies on matters of valuation, damages, lost profits, corporate finance, solvency, business modeling, bankruptcy, and mergers and acquisitions. I have also served as a financial analyst and consultant to numerous companies on mergers and acquisitions, valuation of debt and equity securities, business valuation, leveraged buyouts, private placement of debt and equity, and debt restructuring.

10. In addition, I have testified in federal court and have made presentations on financing strategies, exit strategies for business owners, and understanding financial statements to business groups and law firms. I have designed and taught classes on the determination and calculation of damages as part of Huron's formal training activities.

11. A detailed description of my qualifications and expert testimony during the last four years is provided in Exhibit 2.

Compensation

12. Huron charges an hourly rate of $505 for my time in conducting the research and analysis supporting my opinion and for any testimony I may give. I have supervised others at Huron who also have worked on this project; their hourly rate varies based on their experience level. Neither Huron's fees nor my compensation are contingent on my findings or on the outcome of this litigation.

Summary of Opinions

13. My opinions in this matter are:

I. The misstatements and omissions in NorthWestern's financial statements, Registration Statement in connection with the $720 million in bonds, and other public disclosures during 2002 enabled the Company to complete the October 2002 $87 million equity offering and the transfer of the NorthWestern Energy L.L.C. assets to NorthWestern in November 2002. Had the true information been disclosed to the public prior to October

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8 and November 15, 2002, respectively, the equity offering would not have occurred and the asset transfer would have been impeded by the attempts of security holders and regulators to protect their respective investments and constituents because:

- The market's knowledge that NorthWestern would never realize a return on or cash flow from its significant investment (including preferred stock and intercompany advances) in its unregulated subsidiaries, Blue Dot and Expanets, would have been accelerated.
- The precipitous drop in NorthWestern's stock price would have been accelerated.
- The downgrading of NorthWestern's credit to below investment grade would have been accelerated.
- NorthWestern would have defaulted on financial covenants related to its $280 million facility for which Credit Suisse First Boston ("CSFB") was the administrative agent.[1]
- CSFB would likely not have funded the $280 million facility.
- The suspension of NorthWestern's dividend would have been accelerated.
- The $390 million debt financing with CSFB would have been unlikely.

In each case above, material information, much of which was the focal point of analyses performed by security analysts, rating agencies and investors, was known and withheld from the market place by the management of NorthWestern. The effect of withholding such information was that the Company continued to have access to the financial markets based on public filings, disclosures, and statements that were false and/or which had omitted material information. In reality, this scheme to withhold information allowed the Company to execute the above mentioned transactions.

With knowledge of the undisclosed information, particularly with respect to Expanets and Blue Dot, the market would have readily recognized that NorthWestern was in serious financial trouble. As it was, the Company had progressed through 2002 with a financing plan that was limited and below expectations. As NorthWestern's management was aware, had the true information been known, the Company's ability

[1] Depending on context, CSFB refers to itself and other members of the bank group.

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to continue to finance its operations by raising money in the capital markets would have been severely limited or eliminated altogether. In addition, both security holders and regulators would have acted to protect their interest in NorthWestern Energy, L.L.C. from being transferred to NorthWestern.

II. Had the assets of NorthWestern Energy, L.L.C. not been transferred to NorthWestern, the QUIPS investors would have been covered by the former's assets and not junior to the debt and other liabilities of NorthWestern Corp.

III. Assuming Clark Fork remained liable for the QUIPS obligations; Clark Fork would not have had the financial ability to meet those obligations.

Background

Overview

14. In November 1996,[2] Montana Power Company ("Montana Power") issued, via a trust, 8.45% Cumulative Quarterly Income Preferred Securities, Series A (the "QUIPS") due in 2036.[3] The offering included 2.6 million units with a liquidation preference value of $25 each, for a total of $65 million.[4]

15. On February 15, 2002, NorthWestern acquired Montana Power, which provides electric and natural gas transmission and distribution in Montana, for $478 million in cash and the assumption of $511 million in debt and preferred securities,[5] augmenting similar services NorthWestern provides in South Dakota and Nebraska. Montana Power changed its name to NorthWestern Energy, L.L.C. at the time of the acquisition; however, it remained a wholly owned subsidiary of NorthWestern.[6]

[2] Complaint to Avoid the Transfer of Assets of Clark Fork and Blackfoot LLC (f/k/a NorthWestern Energy LLC) to NorthWestern Corporation, April 2004, p. 4.
[3] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, F-52.
[4] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, F-52.
[5] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 5.
[6] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 5.

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16. At the time of the acquisition, the market generally reacted favorably to the transaction, although equity analysts did express concern about the high leverage that would result based on NorthWestern's financing plan.[7]

17. Consistent with repeated statements by management to rating agencies and others,[8] substantially all of the assets and the majority of the liabilities of the former Montana Power (aka NorthWestern Energy L.L.C.) were transferred to NorthWestern on November 15, 2002.[9] In December 2002, NorthWestern announced significant reductions in earnings due to lower than expected performance at Blue Dot and Expanets, as well as the need to increase reserves for accounts receivable and billing adjustments at Expanets, and the likelihood of a significant impairment charge.[10] In April 2003, through its restated quarterly financial statements for 2002 NorthWestern reported worse financial information.[11] NorthWestern filed for bankruptcy in September 2003.[12]

NorthWestern financing, public announcements and other events

18. NorthWestern undertook several financing activities in 2002. Many of these activities as well as other announcements and events pertinent to NorthWestern's invested capital are listed below:

Date	Event
January 14, 2002	CSFB provided financing for the acquisition in the form of $720 million in term loans.[13] In the same credit agreement, CSFB also provided NorthWestern $280 million in revolving credit loans.[14] Under the credit agreement, the expiration date of the revolving credit facility was

[7] A.G. Edwards, NorthWestern Corporation, Will Investor Attention on Accounting Issues Result in Lower Share Price? We Think Yes, March 19, 2002 (NOR101965-66). Merrill Lynch, NorthWestern Corporation, Transformation Underway, But Execution Risk Remains High, May 1, 2002 (NOR101990-92). A.G. Edwards, Equity Research – Electric Utilities, Montana Commission Approves Acquisition of MPT T&D Business, January 29, 2002 (NOR101960-62).
[8] NorthWestern Corporation, Transcript from First Quarter 2002 Earnings conference call, April 30, 2002, p. 54 (NOR379816). NorthWestern Corporation, Rating Agency Presentation, October 16, 2001 (CSFB015656).
[9] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 5.
[10] Press Release: NorthWestern Lowers Guidance For Estimated 2002 Results, December 13, 2002.
[11] NorthWestern Form 10-Q/A for the period March 31, 2002 filed April 15, 2003. NorthWestern Form 10-Q/A for the period June 30, 2002 filed April 15, 2003. NorthWestern Form 10-Q/A for the period September 30, 2002 filed April 15, 2003.
[12] Press Release: NorthWestern Corporation Files for Reorganization, September 15, 2003.
[13] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), p. 1
[14] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), p. 1.

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Date	Event
	February 14, 2003. NorthWestern would be able to convert up to $225 million of aggregate outstanding into a one year term loan.[15]
March 13, 2002	NorthWestern issued $720 million senior unsecured notes to retire the CSFB $720 million term loan used to acquire Montana Power.[16] These bonds were initially rated BBB+ by Fitch Ratings ("Fitch") and Baa2 by Moody's Investor Service ("Moody's").[17] The notes were not registered at the time of sale.
August 8, 2002	NorthWestern reaffirmed its $2.30 to $2.55 earnings per share ("EPS") target.[18]
September 20, 2002	NorthWestern amended the first and second quarter 2002 10-Q filings addressing concerns raised by the SEC regarding necessary disclosures which were not included in the original filings.[19] Among these disclosures were intercompany advances from NorthWestern to Expanets of $113.4 million and to Blue Dot of $22.8 million as of June 30, 2002[20] and additional discussion of NorthWestern's practice of allocating losses to the minority interests resulting from the acquisitions made by Expanets and Blue Dot as well as quantification of those losses.[21]
October 8, 2002	NorthWestern raised $87 million ($81 million net proceeds) in a common stock offering of 10,000,000 shares[22] at an issue price of $8.75.[23]
October 22, 2002	NorthWestern completed the exchange of its previously issued $720 million unregistered notes for notes which were registered under the Securities Act of 1933.[24]
November 7, 2002	NorthWestern announced that, due to lower projections and the October equity offering, it was reducing forecasted earnings per share from $2.30 to $1.50-$1.60.[25]
November 15, 2002	Substantially all of the assets and a majority of the liabilities in the wholly owned subsidiary NorthWestern Energy L.L.C., except for the Milltown

[15] NorthWestern Corp. Form 424B2 filed October 3, 2002, S-6.
[16] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 13 (MD&A), p. 17.
[17] Fitch press release: NorthWestern Corp's $720MM Sr Notes Rated 'BBB+' By Fitch Ratings, March 8, 2002. Moody's press release: Moody's Assigns Baa2 Rating to NorthWestern Corporation's Planned $700 Million Note Offering, March 5, 2002.
[18] Press Release: NorthWestern Corporation Reports Second Quarter 2002 EPS Of 49 Cents From Continuing Operations; Operating Income Reaches $83.5 Million, August 8, 2002.
[19] Letter from Paul Hastings to the Securities and Exchange Commission, July 12, 2002 (NOR080418-59). Letter from Paul Hastings to the Securities and Exchange Commission, August 16, 2002 (NOR080471-97). Letter from Paul Hastings to the Securities and Exchange Commission, September 6, 2002 (NOR080498-505).
[20] NorthWestern Form 10-Q/A for the period March 31, 2002 filed September 20, 2002, p. 34.
[21] NorthWestern Form 10-Q/A for the period March 31, 2002 filed September 20, 2002, pp. 6-7.
[22] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, F-51.
[23] NorthWestern Form 8-K for the period October 2, 2002 filed October 8, 2002, Exhibit 1.1, Sch. B-1.
[24] Press Release: NorthWestern Corporation Successfully Completes Exchange Offer For 7-7/8% Notes Due 2007 and 8-3/4% Notes Due 2012, October 22, 2002.
[25] Press Release: NorthWestern Reports Third Quarter 2002 Earnings Of 25 Cents Per Share From Continuing Operations, November 7, 2002.

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Date	Event
	Dam, were transferred to NorthWestern[26] in a transaction referred to as "going flat." The entity that retained the Milltown Dam was subsequently renamed Clark Fork and Blackfoot L.L.C. ("Clark Fork").[27]
December 13, 2002	NorthWestern announced that it would miss its 2002 earnings estimates announced on November 7, 2002 due to increased reserves at Expanets and performance issues at Expanets and Blue Dot.[28] It also disclosed that it "may recognize a substantial impairment of goodwill and other intangible assets" at Expanets and Blue Dot.[29]
December 18, 2002	CSFB and NorthWestern entered into a $390 million senior secured term loan credit facility with a term of at least four years.[30] The loan was secured by First Mortgage Bonds ($280 million of which were secured by substantially all of NorthWestern's Montana utility assets and $110 million were secured by the remaining availability of NorthWestern's South Dakota and Nebraska utility assets).[31]
December 20, 2002	Moody's downgraded NorthWestern's senior unsecured debt and issuer ratings from Baa2 to Ba1,[32] a rating that is below investment grade or junk.
December 30, 2002	Standard & Poor's ("S&P") downgraded NorthWestern's corporate credit from BBB+ to BB+,[33] a rating that is below investment grade.
January 16, 2003	Fitch downgraded NorthWestern senior unsecured debt from BBB to BB+,[34] a rating that is below investment grade.
January 27, 2003	The Montana Public Service Commission ("MPSC") approved issuance of First Mortgage Bonds to secure the $390 million loan.[35]
February 10, 2003	The $390 million loan closed.[36] NorthWestern repaid the $280 million revolver.[37]
February 19, 2003	NorthWestern announced that the common stock dividend would be suspended to pay down debt and that it expected to report

[26] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, pp. 5, 106, F-8.
[27] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 17.
[28] Press Release: NorthWestern Lowers Guidance For Estimated 2002 Results, December 13, 2002.
[29] Press Release: NorthWestern Lowers Guidance For Estimated 2002 Results, December 13, 2002.
[30] Press Release: NorthWestern Enters Into $390 Million Secured Credit Facility, December 18, 2002.
[31] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. F-29.
[32] Moody's Investor Services, Global Credit Research Rating Action, Moody's Downgrades Ratings of NorthWestern Corporation (Sr. Sec. To Baa3); Continues to Review Ratings for Possible Further Downgrade, December 20, 2002.
[33] Standard & Poor's Research Update NorthWestern Corp., December 30, 2002.
[34] Fitch press release: NorthWestern Downgraded By Fitch Ratings; Rating Outlook Negative, January 16, 2003 (NOR035384). Fitch Ratings, Corporate Finance, NorthWestern Corporation, February 6, 2003 (NOR058336).
[35] Department of Public Service Regulation before the Public Service Commission of the State of Montana, In the Matter of the Application of NorthWestern Corporation for Authority to Consummate a Credit Agreement and Issue $390 Million in Principal Amount of Secured Long-Term Notes in the Form of First Mortgage Bonds, Final Order, January 27, 2003 (NOR001606-17).
[36] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 6.
[37] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 6.

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Date	Event
	approximately $700 million in charges in its 2002 results.[38]
April 15, 2003	NorthWestern filed its 2002 10-K and restated the first three quarters of 2002. It reported it would no longer be paying cash dividends for the foreseeable future.[39]
September 15, 2003	NorthWestern announced it filed for Chapter 11 bankruptcy and would be delisted from the New York Stock Exchange.[40]

NorthWestern management knowledge

19. Based on my review of Mr. Berliner's report as well as many of the documents which underlie his statements, there is considerable evidence during 2002 that Company management was aware of several material items that a reasonable investor would need to know to make an informed investment decision. Many of these were concealed by the incorrect financial statements that the Company filed in the first three quarters of 2002 including but not limited to the reserves and other issues at Expanets, the likelihood of an impairment of Expanets and Blue Dot, and the difficulties related to monetizing certain assets, including the transmission assets at Colstrip. I highlight these issues below.

20. The SEC also addressed these items:

> NorthWestern also misrepresented or did not disclose, among other things, the effects of significant problems with Expanets' new information technology system, the material impact of Expanets' reserve reductions and its receipt of non-compete payments on Expanets' income, large intercompany advances NorthWestern made to support Expanets and Blue Dot, and the timing of anticipated payments from the sale of certain utility assets. Through its financial misstatements, misrepresentations and omissions, NorthWestern obscured the continuing poor performance of its subsidiaries at a time when it was publicly relying on these subsidiaries' operations to strengthen its financial condition.[41]

[38] Press Release: NorthWestern Corporation Outlines Turnaround Plan Company Will Focus on Core Utility Business, Improving Liquidity and Paying Down Debt Common Stock Dividend Suspended Company Projects Charges of Approximately $700 Million in 2002, February 19, 2003.
[39] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 81.
[40] Press Release: NorthWestern Corporation Files for Reorganization, September 15, 2003.
[41] Securities and Exchange Commission, Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, March 7, 2007, p. 2.

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21. Management of NorthWestern was aware throughout 2002 that Expanets' earnings were not being reported accurately.[42] NorthWestern management was, as an example, directing Expanets to meet its EBITDA targets by reducing its reserves for bad debt expense and billing adjustments.[43] These were among the very items which were later restated.

22. On September 18, 2002, a presentation was made to NorthWestern revealing that of Expanets' accounts receivables, $52 million was over 180 days old and $21 million was over 300 days old.[44] NorthWestern management instructed, however, that the proper reserves for these outstanding amounts not be made.[45] The SEC noted that though the uncollectible accounts receivable issue was not disclosed in NorthWestern's 10-Q filings for the first or second quarters of 2002, it was disclosed in the third quarter, but the SEC stated, "this disclosure was inadequate since NorthWestern knew at that time that Expanets' bad debt reserve was materially insufficient."[46]

23. In his timeline, Richard Fresia, CFO of Expanets,[47] stated, "[i]n the July [2002] Operations review meeting, I advised the NOR senior team that billing adjustments for the year 'may be as high as $30M'".[48] However, as also noted by the SEC, though it was aware of the need to increase the billing adjustment reserve at Expanets, NorthWestern management actually reduced the reserve in the second and third quarters of 2002 to increase income in those quarters.[49]

24. Additionally, though NorthWestern management was clearly aware of the amount of its intercompany advances to Expanets and Blue Dot, they were not disclosed in NorthWestern's original 10-Q filings for the first or second quarters of 2002. This was

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[42] Declaration to Paul Hastings Janofsky & Walker LLP by Kipp Orme, April 2003 (NOR519889-90).
[43] Declaration to Paul Hastings Janofsky & Walker LLP by John Charters, April 11, 2003 (NOR519910-12).
[44] Expanets Collections Strategy Discussion Presentation, September 18, 2002 (NOR306807).
[45] Declaration to Paul Hastings Janofsky & Walker LLP by Richard Fresia, April 18, 2003 (NOR519917-18).
[46] Securities and Exchange Commission, Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, March 7, 2007, p. 5.
[47] Deposition of Richard Fresia, April 30, 2007, pp. 7-8.
[48] Fresia Exhibit 13, Timeline of key events (ultimately) leading to 12/31/02 reserve (NOR306791-92). E-mail from Rick Fresia to Marty Snella RE: Gap in reported revenue for July dated August 6, 2002 (NOR306793).
[49] Securities and Exchange Commission, Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, March 7, 2007, p. 6.

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significant as by June 30, 2002, NorthWestern had approximately $113.4 million in intercompany advances, increasing nearly 100% during the quarter from the March 31, 2002 balance of $63.3 million,[50] in addition to the disclosed $51.4 million of additional indebtedness to Expanets and $22.8 million in intercompany advances to Blue Dot.[51] The intercompany advances were included in the first 10-Q/A filed on September 20, 2002.[52] By September 30, 2002, the intercompany advances to Expanets totaled $191.2 million.[53]

25. Internal documents also reflect that NorthWestern management understood a substantial impairment of Expanets and Blue Dot was likely during 2002, however, NorthWestern did not disclose the amount of the impairment until April 15, 2003 in connection with the filing of its annual 10-K. One of the reasons this information was withheld was to enable NorthWestern to finalize its new financing and to avoid a covenant violation on its $280 million CSFB facility as the following implies.

> …the Board should determine its financing plan as soon as practicable, preferably by the week of December 9. The combination of underperformance, increasing of reserves, and potential SFAS 142 impairments at the unregulated businesses not only potentially jeopardize NorthWestern's ability to term-out its existing credit facility in February should there be any problem in executing the FMB [first mortgage bond] financing, but also could potentially result in an earlier covenant breach following completion of the company's SFAS 142 impairment analysis and final sign off by Deloitte (likely to occur in mid to late January or early February).[54]

26. Regarding the monetization of assets, NorthWestern, knowing the market was concerned about its liquidity, stated that it expected to collect $97 million in Colstrip proceeds in June or July 2002.[55] As late as August 8, 2002, NorthWestern told

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[50] NorthWestern Form 10-Q/A for the period March 31, 2002 filed September 20, 2002, p. 34.
[51] NorthWestern Form 10-Q/A for the period June 30, 2002 filed September 20, 2002, p. 45.
[52] NorthWestern Form 10-Q/A for the period June 30, 2002 filed September 20, 2002, p. 45.
[53] NorthWestern Form 10-Q for the period September 30, 2002 filed November 14, 2002, p. 44.
[54] Memo from M. Lewis and D. Hylland to the Board of Directors Re: NOR Financing Status and Recommendations, December 7, 2002 (NOR063739)
[55] United States District Court, District of South Dakota, Southern Division, Securities and Exchange Commission, Plaintiff, v. Richard R. Hylland, Defendant, Complaint, April 25, 2007, p. 26.

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analysts, "[w]e do intend to close on that transaction within the next couple months and that would bring in $97 million in proceeds."[56]

27. However, NorthWestern did not disclose that its receipt of those proceeds was uncertain and that it initiated a lawsuit against the potential purchaser of the Colstrip assets.[57] On August 5, 2002, NorthWestern filed a complaint against the other party and served the complaint on September 4, 2002, disclosing the lawsuit at that time.[58] With the lawsuit, the ultimate completion of the transaction would be perceived by the market as more difficult.

General market conditions

28. As a result of the rampant economic disturbances in 2001, including the Enron scandal and the September 11 terrorist attacks, 2002 began with weak and uncertain financial markets. The manifestation of which was generally referred to as a "flight to quality"[59] due to market participants heightened risk aversion. Investors and creditors were particularly weary of companies with "questionable accounting practices" and highly leveraged balance sheets.[60] Companies with these characteristics generally experienced declining stock prices and higher interest costs,[61] as well as increasing pressure to reduce their debt.[62]

29. Utility companies were not isolated from the inhospitable financial markets. The industry faced poor fundamentals due to an increasing power supply and subsequently lower prices leading to continued reductions in earnings.[63] In the first quarter of 2002,

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[56] NorthWestern Corporation's Second Quarter Earnings Release conference call transcript, August 8, 2002, p. 26 (NOR099958).

[57] United States District Court, District of South Dakota, Southern Division, Securities and Exchange Commission, Plaintiff, v. Richard R. Hylland, Defendant, Complaint, April 25, 2007, p. 26. Press Release: NorthWestern and PPL Montana Reach Agreement in Principle to Settle Litigation Claims, May 4, 2005.

[58] United States District Court, District of South Dakota, Southern Division, Securities and Exchange Commission, Plaintiff, v. Richard R. Hylland, Defendant, Complaint, April 25, 2007, pp. 26-27.

[59] International Monetary Fund, Global Financial Stability Report Market Developments and Issues, June 2002, p. 9.

[60] International Monetary Fund, Global Financial Stability Report Market Developments and Issues, June 2002, p. 2.

[61] International Monetary Fund, Global Financial Stability Report Market Developments and Issues, June 2002, p. 2.

[62] International Monetary Fund, Global Financial Stability Report Market Developments and Issues, June 2002, p. 12.

[63] I note that for the most part, the regulated businesses of NorthWestern, including the Montana utility operations, were not subject to these pricing impacts. Deutsche Bank Electric Power Monthly, April 2, 2002. Bear Stearns Utility Review, August 9, 2002. Salomon Smith Barney Industry Note Utilities, October 8, 2002.

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U.S. electric power distribution companies' earnings were 21% lower on average than the first quarter of 2001.[64]

30. The pervasiveness of weak balance sheets and corresponding liquidity issues as well caused ratings agencies to view utilities with additional scrutiny and more proactively adjust the ratings of weaker companies.[65] The ratings agencies' influence on the financial markets was expanding during this period and their criticisms led to a "negative bias" for the entire utility industry.[66] According to Salomon Smith Barney, debt for the industry was trading at significant discounts "reflecting strong investor concerns".[67] The equity market, adopting this concern, was highly focused on the outstanding debt levels of utility companies. Many analysts were recommending underweighting electric utilities in investment portfolios during 2002.[68]

31. The financing situation for utilities firms was so dire by mid-October 2002 that one analyst deemed the capital markets "essentially closed to these companies, with equity financing unavailable and future debt refinancings likely occurring only on a secured basis and at unattractive terms. In fact, debt ratings and credit spreads already reflect the erosion of investor confidence in these companies' financial condition".[69]

32. Another analyst summarized the situation as follows:

> Little did we know that the big splash created by Enron's demise last year would escalate into a tidal wave by mid-2002. That wave has eroded investors' confidence in energy markets, drying up much needed capital prompting the cancellation or postponement of most power plant development projects and essentially halting power energy trading activities. Increased cost of capital combined with declining near-term profit margins resulted in significant EPS erosion in 2002. The wave was swift, unforeseen and the loss of capital significant.[70]

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[64] Deutsche Bank Securities Inc., U.S. Electric Power Review Industry Quarter Earnings Review, May 13, 2002.
[65] Baird, Utility Monthly, September 2002, p. 2.
[66] Bear Stearns, Utility Review, June 4, 2002.
[67] Salomon Smith Barney, Multi-Company Note, Electric Utilities, October 18, 2002.
[68] Bear Stearns, Monthly Utility Review, October 18, 2002. Salomon Smith Barney, Multi-Company Note, Electric Utilities, October 18, 2002. Salomon Smith Barney, Electric Utilities Weekly Energy Wire, November 26, 2002. Deutsche Bank, U.S. Electric Power Industry, August 12, 2002. Deutsche Bank, U.S. Electric Power Industry, October 4, 2002. Deutsche Bank, U.S. Electric Power Monthly, October 7, 2002. Deutsche Bank, U.S. Electric Power Monthly, December 6, 2002.
[69] Salomon Smith Barney, Multi-Company Note, Electric Utilities, October 18, 2002, p. 2.
[70] Baird, Utility Monthly, September 2002, p. 2.

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33. As shown in Exhibit 3, both the S&P and Dow Jones utility indices underperformed the broader market in 2002. This chart also shows that NorthWestern's stock price lagged behind the industry for the majority of the year and substantially so in the latter half. From the time of the acquisition of Montana Power on February 15, 2002 to December 12, 2002, just before its announcement that it would miss its November 2002 revised earnings target, NorthWestern's stock price dropped approximately 65% (from $21.60 to $7.61) to a 15-year low, while the utilities indices dropped less than 30% during the same period.[71] Over the next two months, NorthWestern's stock fell another 66% to $2.60 on February 19, 2003 when NorthWestern announced it would be suspending its dividend payment.[72]

Equity analyst view of NorthWestern prior to restatement

34. Based on information released by NorthWestern, filings with the SEC and calls with equity analysts prior to November 2002, analysts at a number of investment banking firms generally believed that the Company was on target to meet its 2002 earnings estimate of $2.30 per share, even recommending that investors purchase NorthWestern's stock in the first half of 2002.[73] The equity analysts' optimism stemmed from the stability of NorthWestern's regulated utility business and the consistency of NorthWestern's dividend,[74] as well as their beliefs that NorthWestern would achieve "EBITDA of $330-$355 million and a year-end free cash flow run rate of $100 million"[75] for 2002 and strengthen its liquidity position through the issuance of equity and the sale of its Colstrip-related transmission assets.[76]

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71 Bloomberg stock quote data
72 Press Release: NorthWestern Corporation Outlines Turnaround Plan Company Will Focus on Core Utility Business, Improving Liquidity and Paying Down Debt Common Stock Dividend Suspended Company Projects Charges of Approximately $700 Million in 2002, February 19, 2003.
73 UBS Warburg, Global Equity Research, NorthWestern Corp., April 30, 2002. Merrill Lynch, NorthWestern Corporation, May 1, 2002 (NOR101990). Merrill Lynch, NorthWestern Corporation, May 17, 2002 (NOR101994). Merrill Lynch, NorthWestern Corporation, June 25, 2002 (NOR053471). Merrill Lynch, NorthWestern Corporation, August 9, 2002 (NOR234617). Merrill Lynch, NorthWestern Corporation, August 19, 2002 (NOR026460). Morgan Stanley, NorthWestern Corp., May 17, 2002 (NOR053430).
74 Morgan Stanley, NorthWestern Corp., April 25, 2002 (NOR053319-28). Merrill Lynch, NorthWestern Corporation, August 9, 2002 (NOR234617-20).
75 UBS Warburg, Global Equity Research, NorthWestern Corp, July 18, 2002.
76 UBS Warburg, Global Equity Research, NorthWestern Corp, July 18, 2002. Merrill Lynch, NorthWestern Corporation, August 9, 2002 (NOR234617-20).

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35. These expectations proved to be wrong when NorthWestern announced on November 7, 2002, that it was lowering its 2002 earnings forecast to $1.50-$1.60 per share as a result of lowered EBITDA projections for Expanets and Blue Dot and adjustments related to the additional common shares from the October 2002 offering.[77]

36. Prior to this announcement, analysts had expressed concerns about the unregulated subsidiaries. However, these concerns were abated by the Company's release of information on the "dramatic transformation"[78] at Expanets and its "EBITDA level of $80 to $87 million"[79] for 2002 as well as the "improvement for the second half of [2002]"[80] at Blue Dot, with EBITDA targets of $15 to $20 million.[81] The Company also told analysts in August 2002 that "[d]uring the balance of the year when you look at the projections, they will certainly be paying their dividends in cash and, in fact, we would look for payments in excess of the actual dividends so we can start working back down to preferred stock investment. Blue Dot, during the balance of the year we would see them having an ability to pay roughly half of their dividends in cash."[82]

37. HSBC reported its understanding of the situation as follows:

> Cash flows to the parent from its non-regulated subsidiaries are expected to improve during [the second half of 2002]: $20mn dividends from Expanets are expected to be in cash, and half of Blue Dot's $20mn dividend in [the second half] will be in cash. Also, Expanets may begin to return capital to parent NOR though redemption of preferred stock.[83]

38. Additionally, the analysts generally believed based on management representations that the accounts receivable (collectability) issues Expanets had experienced due to the implementation of a new enterprise software system, Expert,[84] would "be reduced

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[77] Press Release: NorthWestern Reports Third Quarter 2002 Earnings Of 25 Cents Per Share From Continuing Operations, November 7, 2002.
[78] NorthWestern Corporation's Second Quarter Earnings Release conference call transcript, August 8, 2002, p. 4 (NOR099936).
[79] NorthWestern Corporation's Second Quarter Earnings Release conference call transcript, August 8, 2002, p. 17 (NOR099949).
[80] NorthWestern Corporation's Second Quarter Earnings Release conference call transcript, August 8, 2002, p. 5 (NOR099937).
[81] NorthWestern Corporation's Second Quarter Earnings Release conference call transcript, August 8, 2002, p. 21 (NOR099953).
[82] NorthWestern Corporation's Second Quarter Earnings Release conference call transcript, August 8, 2002, p. 35 (NOR099967).
[83] HSBC, NorthWestern Corporation, 2Q Results Imply Solid Year-End Outlook, August 13, 2002.
[84] NorthWestern Form 10-Q/A for the period March 31, 2002 filed September 20, 2002, p. 21.

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to normal levels".[85] Merrill Lynch reported in May 2002 that "[t]he significant cost expense associated with putting in a new back office is now finally paying off..."[86] As late as September 20 in its amended 10-Q for the first quarter, NorthWestern reported that "[t]he [Expert] system is now fully operational and savings are expected to continue throughout 2002."[87]

39. The analysts also believed that "...the problem units/regions [of Blue Dot] have been identified and the company is implementing a management restructuring."[88]

40. As discussed above, equity analysts during 2002 were acutely aware of highly leveraged capital structures, and NorthWestern's liquidity constraints, which were exacerbated by the debt incurred for the Montana Power acquisition, were therefore troubling to the market. Bear Stearns, NorthWestern's own financial advisor, addressed this situation in a September presentation to NorthWestern's Board of Directors: "NorthWestern's stock price performance has suffered as the equity markets have grown concerned about the Company's debt ratios and the lack of flexibility within NorthWestern's capital structure."[89] A handwritten note on a page of the presentation describes the consequences to NorthWestern resulting from this lack of flexibility - "slippage in EBITDA would be catastrophic".[90]

41. Notwithstanding NorthWestern's precarious financial position (which later would be proven to be much worse), NorthWestern issued 10,000,000 shares of common stock at $8.75 per share, with net proceeds of $81 million on October 8, 2002, a mere 40% of the initially planned $200 million offering. This financing did little to allay concerns about the Company's ability to reduce debt or improve its financial flexibility and in hindsight only served to postpone the inevitable bankruptcy filing that occurred later in 2003.

> Despite a very difficult financing environment, the Company was able to successfully complete its 10 million share offering, raising net proceeds of $82.5 MM... The issue price of $8.75 was somewhat disappointing to the

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[85] UBS Warburg, Global Equity Research, NorthWestern Corp., May 20, 2002.
[86] Merrill Lynch, NorthWestern Corporation, May 1, 2002, p. 2 (NOR101991).
[87] NorthWestern Form 10-Q/A for the period March 31, 2002 filed September 20, 2002, p. 21.
[88] Morgan Stanley, NorthWestern Corp., New, More Regulated Look, Attractive Valuation, April 25, 2002 (NOR053320).
[89] Bear Stearns Presentation to NorthWestern Corporation, September 12, 2002, p. 3 (NOR349346)
[90] Bear Stearns Presentation to NorthWestern Corporation, September 12, 2002, p. 8 (NOR349354)

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> market, both in terms of dilution and the signals being sent about share price levels... The Company's trading levels (2003 P/E around 3.8x and 15+% dividend yields) suggest that the market continues to have questions about both liquidity and NorthWestern's long-term strategy.[91]

42. The concerns expressed above as well as similar comments made by other analysts obviously could not reflect the Company's true situation due to the more optimistic false information consistently provided by management to the market at this time.

43. Indeed, in July 2002 prior to the October stock offering, the equity markets were questioning the prudence of the transaction before any knowledge of the financial restatements that would later take place as described in the following: "The company has previously indicated that it plans to issue approximately $200 million in new equity to strengthen its balance sheet. We believe that, in the current market environment, the risks and potential dilution for this type of transaction have increased."[92] NorthWestern's own financial advisor, Bear Stearns, warned that because of the stock price discount to the market,[93] the equity offering could be "highly dilutive,"[94] and as a result, Bear Stearns stated that all of its financing alternatives which did not include issuance of common equity would ultimately "provide significantly more value to shareholders".[95]

44. Following NorthWestern's November 2002 announcement of the decreased earning estimate described above and a subsequent December 2002 announcement stating that it would miss the $1.50-$1.60 per share estimate from November and would be recording substantial charges at year end, certain equity analysts commented that a change to NorthWestern's dividend policy including a suspension of the dividend, which had been consistent for many years, was likely.[96] They also expressed concern that the unregulated subsidiaries, which they had believed to be improving, would

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91 Bear Stearns Presentation to NorthWestern Corporation, November 6, 2002, p. 1 (NOR054686).
92 UBS Warburg, Global Equity Research, NorthWestern Corp., July 18, 2002, p. 2.
93 Bear Stearns Presentation to NorthWestern Corporation, September 12, 2002, p. 24 (NOR349374).
94 Bear Stearns Presentation to NorthWestern Corporation, September 27, 2002, p. 6 (NOR255876).
95 Bear Stearns Presentation to NorthWestern Corporation, September 23, 2002, p. 3 (NOR057819).
96 Morgan Stanley, NorthWestern Corp., Unreg Expected to Fall Short; Lowering Estimates, November 11, 2002 (NOR026678). RBC Capital Markets, NorthWestern Corp., Aggressive Growth Strategy Creates Problems, February 18, 2003.

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require additional capital, diverting funds from the debt repayment they had been expecting.[97]

45. In response to the announcement, a Morgan Stanley analyst noted its loss of trust in NorthWestern's management causing it to preemptively assume a full write-down prior to the actual disclosure in April 2003: "We are lowering our ongoing EPS estimate to $1.00 on management's guidance that the non-utility subsidiaries, principally telecom, has deteriorated even more than previously admitted. For practical purposes, we would consider these subsidiaries likely to be completely written off and unlikely to contribute to parent cash flow or EPS."[98] Still, the analyst could not predict the ultimate loss of $30.04 per diluted share for 2002.[99]

46. By February 2003, many analysts had stopped coverage of NorthWestern. One that continued coverage wrote the following:

- "In addition to the above problems, we believe that certain management actions have had a negative impact on investor confidence in NorthWestern and its management team. These actions include: Providing positive earnings guidance throughout most of 2002 and issuing an earnings warning shortly after the completion of the company's equity issuance in October 2002..."[100]
- "... the company has encumbered all of its utility assets in order to secure the new $390 million senior secured term loan credit facility and the new facility has restrictions on additional indebtedness. Given NorthWestern's current stock price, its debt leverage and encumbrances, it may be difficult to raise capital at a reasonable cost. ...NorthWestern's ability to access capital could also be negatively impacted by recent downgrades in its debt ratings by Standard and Poor's, Moody's and Fitch to below investment grade."[101]
- "The Company's current ratings are as follows: Standard and Poor's, BB+; Moody's, Ba1; and Fitch, BB+. If NorthWestern continues to maintain its annual dividend at $1.27, the forecast dividend payout ratios for 2003 and 2004 are in excess of 100%. We believe this situation is not sustainable over the long run and believe there is a high probability that the dividend will be cut or eliminated in light of the February 6,

[97] Morgan Stanley, NorthWestern Corp., Unreg Expected to Fall Short; Lowering Estimates, November 11, 2002 (NOR026678).
[98] Morgan Stanley, NorthWestern Corp, Lowering Ests. On Guidance – A Real Workout Story Now, December 16, 2002 (NOR035357).
[99] Press Release: NorthWestern Corporation Reports 2002 Financial Results, Company Reports Loss of $892.9 Million for Full-Year 2002, April 16, 2003.
[100] RBC Capital Markets, NorthWestern Corporation, Pessimism Overhangs Stock, February 18, 2003, p. 4.
[101] RBC Capital Markets, NorthWestern Corporation, Pessimism Overhangs Stock, February 18, 2003, p. 23.

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2003 announcement that NorthWestern's board of directors deferred a decision on the Company's common stock dividend."[102]

- "We believe that a number of factors have had and could continue to have a negative impact on investor confidence in NorthWestern and its management team. These factors include the sharp decline in Company's share price in recent months; the pending bankruptcy of CornerStone; continued operational difficulties at Expanets and Blue Dot; substantial indebtedness associated with the NorthWestern's business acquisitions; and concerns over executive compensation, accounting practices and consulting fees."[103]

Rating agency view of NorthWestern prior to restatement

47. Until December 2002, all of the Company's debt maintained investment grade ratings. Exhibit 4 includes a summary of the changes in the ratings on NorthWestern's senior secured, senior unsecured, senior notes, first mortgage bonds, and issuer ratings from 2000 through NorthWestern's bankruptcy in 2003.

48. As discussed below, the agencies viewed the planned equity offering and transfer of assets from Montana Power to NorthWestern as necessary to maintain the Company's investment grade ratings. However, the ratings agencies were focused on several items including NorthWestern's tight liquidity, its increased debt level leading to a highly leveraged capital structure, and volatility at the unregulated subsidiaries. Additionally, if the equity offering or the asset transfer were not completed, the agencies indicated that NorthWestern's ratings would be impacted.

49. By the end of 2001, NorthWestern's liquidity issues were of significant concern to the rating agencies. In November 2001, Moody's stated that it was "concerned about NorthWestern's significant increase in recourse debt and debt-like obligations that will be taken on as a result of the acquisition of MPC's utility assets."[104] Following through on the concerns both Moody's and S&P downgraded NorthWestern's credit in late 2001. Moody's reasoning for this downgrade included NorthWestern's increasing debt leverage and a weak cash flow coverage.[105]

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[102] RBC Capital Markets, NorthWestern Corporation, Pessimism Overhangs Stock, February 18, 2003, p. 2.
[103] RBC Capital Markets, NorthWestern Corporation, Pessimism Overhangs Stock, February 18, 2003, p. 2.
[104] E-mail from C. Thomson to J. Finch and D. Welch Re: Moody's Press Release, November 20, 2001 (CSFB010284-85).
[105] E-mail from C. Thomson to J. Finch and D. Welch Re. Moody's Press Release, November 20, 2001 (CSFB010284).

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50. In addition to the liquidity issues caused by NorthWestern's leveraged capital structure, after the Montana Power acquisition, the ratings were also negatively impacted by the performance of Expanets and Blue Dot.[106] NorthWestern acknowledged this concern stating "[the rating agencies] will at least be very pleased to see the turnaround at Expanets, which was a major concern of theirs."[107] The rating agencies recognized that the relatively stable cash flows from NorthWestern's utility business[108] offset some of the risks identified by the ratings agencies with respect to the Company's unregulated subsidiaries. The regulated business, unlike Expanets and Blue Dot, benefited from "low industrial sales, profitable off-system energy sales, low power costs, reasonable regulation, adequate generating capacity, and supply contracts".[109] However, the positive benefits of the stable utility cash flow could not overcome the substantial negative financial performance that, though hidden by the misstatements and omissions by management and thus not apparent to the agencies at the time, was occurring at Expanets and Blue Dot.

51. In fact, in a September 12, 2002 presentation to NorthWestern's Board of Directors, Bear Stearns points out in a sensitivity analysis that "[a] 50% reduction in Expanets projected cash flow would critically impair the Company's balance sheet."[110] At the time, NorthWestern management had not disclosed that Expanets' cash flows were negative necessitating $113.4 million in intercompany advances through June 30, 2002 from NorthWestern.[111]

52. Due to the rating agencies' focus on NorthWestern's liquidity and leverage, the continuation of its investment grade ratings were predicated on an anticipated $200 million equity offering as described below:

> The expectation of another material, near term common equity issuance as part of the take-out financing is an important factor in Moody's rating determinations. Furthermore, the rating determinations assume that

[106] Moody's Investor Services, Global Credit Research Rating Action, Moody's Assigns Baa2 Rating to NorthWestern Corporation's Planned $700 million Note Offering, March 5, 2002.
[107] Jacobsen Exhibit 7, Memo from K. Orme to M. Lewis, D. Hylland and E. Jacobsen Re: Financing Plans and Considerations, May 28, 2002 (NOR056240).
[108] Moody's Investor Services, Fundamental Credit Research Opinion Update, NorthWestern Corp., December 6, 2001 (CSFB009055).
[109] Standard & Poor's Research, NorthWestern Corp., December 26, 2001 (CSFB009049).
[110] Bear Stearns Presentation to NorthWestern Corporation, September 12, 2002 (NOR349356).
[111] NorthWestern Form 10-Q/A for the period June 30, 2002 filed September 20, 2002, p. 45.

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management will continue to carefully manage NW's capital structure and issue additional common equity, if necessary, to achieve more financial flexibility.[112]

53. The equity analysts as well acknowledged this fact: "While we believe $200mm in total equity is still in the works to maintain a solid BBB credit rating, equity financing remains a challenge at current levels. But equity is a must, and we effectively see NOR coming to the market in smaller trenches, and to potentially both the public and private equity markets."[113]

54. Therefore, the shortfall in the October offering led to another round of ratings downgrades.[114] As S&P explained, "NorthWestern was expected to issue $200 million of additional equity to support the company's financial measures, but was only able to issue $83 million due to the substantial decline in the company's stock price that continues to persist."[115] These market reactions took place based on the information available at the time, which did not yet incorporate the additional negative information that would soon be revealed.

55. Another factor keeping NorthWestern's ratings higher was the expectation that the Montana utility assets would be transferred to NorthWestern,[116] because that "structure favors NOR bondholders as they will not be structurally subordinated to outstanding MPC [Montana Power] debt obligations."[117] If that did not occur, the agencies had warned the ratings would be impacted: "In the unlikely event that the collapsing of Montana Power L.L.C. into a division of NOR does not occur as planned, then Moody's would reassess the need to account for a structural subordination relating to NOR's obligations. Under this scenario, a one-notch downgrade of NOR's ratings would be a likely outcome, all other factors being equal."[118] In fact, appeasing the rating agencies

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[112] E-mail from C. Thomson to J. Finch and D. Welch, Re: Moody's Press Release, November 20, 2001 (CSFB010284-86).
[113] Merrill Lynch, NorthWestern Corp., Focusing on Cash, August 9, 2002 (NOR250196).
[114] Fitch press release: Fitch Dwngr NorthWestern Corp Sr Sec To 'BBB+'; Outlook Negative, October 14, 2002.
[115] Standard & Poor's Research Update, Northwestern Corp., December 30, 2002, p. 2.
[116] Fitch press release: Fitch Dwngr NorthWestern Corp Sr Sec To 'BBB+'; Outlook Negative, October 14, 2002.
[117] Fitch press release: NorthWestern Corp's $720MM Sr Notes Rated 'BBB+' By Fitch Ratings, March 8, 2002.
[118] Moody's Investor Services, Global Credit Research Rating Action, Moody's Assigns Baa2 Rating to NorthWestern Corporation's Planned $700 million Note Offering, March 5, 2002.

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was specifically identified as a reason for the Board of Directors to approve the board resolution to transfer the assets and liabilities.[119]

56. Less than a month after the asset transfer, NorthWestern announced that it would miss its earnings estimate due to lower than expected performance at Blue Dot and Expanets as well as the need to increase reserves, and the likelihood of a significant impairment charge.[120] Based on this December 2002 announcement, ratings for all but NorthWestern's senior secured debt and first mortgage bonds were dropped to junk status.[121] Even at this point, however, the announcement understated the problems of which NorthWestern management was aware.

57. In commentary surrounding its December 20, 2002 downgrade, Moody's noted "that absent access to the funds under the new CSFB facility -- which would facilitate termination of the existing $280 million facility -- the recent [December 13] announcement related to expected non-cash charges could jeopardize NOR's ability to remain in compliance with some of the financial covenants in that facility (e.g.; the funded debt to capital ratio as defined within the loan document)."[122] Had accurate financials been available, NorthWestern would have already been in default.

58. S&P additionally predicted in December 2002 that "given the company's current stock price of half its book value [$5.10 on December 30, 2002], and general equity market conditions, Standard & Poor's does not believe the company will issue addition[al] equity in the foreseeable future… Standard & Poor's also remains concerned about the company's ability to issue equity over the next four to five years."[123]

Financial restatement on April 15, 2003

59. On April 15, 2003, NorthWestern issued its annual form 10-K filing as well as amended 10-Q filings for the first three quarters of 2002 (this was the second time the quarterly 2002 10-Q filings were amended). There were a number of adjustments in the

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[119] NorthWestern Corporation, Board of Directors Minutes of Regular Meeting, August 7, 2002 (NOR009571)
[120] Press Release: NorthWestern Lowers Guidance For Estimated 2002 Results, December 13, 2002.
[121] See Exhibit 4.
[122] Moody's Investor Services, Global Credit Research Rating Action, Moody's Downgrades Ratings of NorthWestern Corporation (Sr. Sec. To Baa3); Continues to Review Ratings for Possible Further Downgrade, December 20, 2002 (NOR099653).
[123] Standard & Poor's Research Update, NorthWestern Corp., December 30, 2002.

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quarterly restated filings including but not limited to: (1) reduction in revenue and accounts receivables related to estimated billing adjustments, (2) increase in bad debt expense and accounts receivable reserves, (3) decrease in revenues based on the completed contract method of accounting, (4) increase in expenses related to Expanet's new enterprise software system, Expert, that were originally capitalized, and (5) increase in expenses related to an employee benefit plan.[124] Also, in the fourth quarter of 2002, NorthWestern recorded a large impairment of goodwill and other long-lived assets in recognition of the severe problems that NorthWestern was experiencing at Blue Dot and Expanets.[125]

60. The following table (in millions) lists the significant charges from the 2002 10-K[126]:

Impairment of Blue Dot goodwill and other long-lived assets	$	301.7
Impairment of Expanets goodwill and other long-lived assets		288.7
Discontinued operations of CornerStone Propane, net of tax benefits		101.7
Valuation allowance for deferred tax assets		71.5
Expanets billing adjustments and accounts receivable write-offs and reserves		65.8
Impairment of Montana First Megawatts project		35.7
Retirement of acquisition term loan, net of tax benefits		13.4
	$	878.5

61. The following table (dollars in millions) contains a comparison of high level financial metrics as originally reported for the first three quarters to the restated values as well as fourth quarter financials (see Exhibit 5 for details).

	1st Qtr 2002		2nd Qtr 2002		3rd Qtr 2002		4th Qtr 2002
	Original	Restated	Original	Restated	Original	Restated	Original
Net Income	$ (29.5)	$ (46.1)	$ 15.8	$ (13.9)	$ (41.3)	$ (55.4)	$ (748.6)
EBITDA	$ 62.3	$ 38.2	$ 81.1	$ 49.7	$ 77.7	$ 55.6	$ (645.2)
Equity	$ 357.4	$ 340.8	$ 357.3	$ 311.0	$ 298.9	$ 238.6	$ (456.1)

62. As summarized by the SEC in its Cease and Desist order, "NorthWestern overstated its income from continuing operations for the first three quarters of 2002 by approximately 176%, 618%, and 109%, respectively due to the company's improper

[124] NorthWestern Form 10-Q/A for the period March 31, 2002 filed April 15, 2003, p. 3. NorthWestern Form 10-Q/A for the period June 30, 2002 filed April 15, 2003, pp. 4-5.
[125] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 6
[126] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 6.

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accounting for accounts receivable, adjustments to customers' bills, and allocation of losses to minority interests."[127]

63. NorthWestern stated in its 10-K that "[i]t has become increasingly apparent that we will never recover our investments in these entities and that these entities will not generate cash flows in sufficient amounts to provide meaningful contributions to our debt service."[128] This acknowledgement appears to be a significant departure from the $86 to $96 million of EBITDA, that the Company was predicting for Expanets and Blue Dot as late as November 6, 2002.[129] As discussed above, internal correspondence in addition to other Company documents make it apparent that NorthWestern management knew about the problems at Expanets and Blue Dot before November 2002.

64. As the SEC stated in its complaint against Richard Hylland, president and Chief Operating Officer of NorthWestern,[130]

> Hylland and other NorthWestern senior executives were informed that neither entity was providing meaningful cash to NorthWestern, that NorthWestern was actually required to fund these operations more than originally planned, and that NorthWestern failed to properly disclose this information. ...Hylland and other NorthWestern senior executives were also informed about the effect these advances had on NorthWestern's financial condition, including their likely impact to its liquidity, and that such information was material to the public, including analysts and rating agencies.[131]

65. Given the insufficient information regarding NorthWestern's financial difficulties that NorthWestern had previously disclosed to the public, the market reaction following the April 15, 2003 financial disclosure was rapid and punishing. Within days, all three major rating agencies had dropped the Company's senior secured debt rating to junk

[127] Securities and Exchange Commission, Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, March 7, 2007, p. 2.
[128] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 6.
[129] Press Release: NorthWestern Reports Third Quarter 2002 Earnings Of 25 Cents Per Share From Continuing Operations, November 7, 2002.
[130] Deposition of Richard Hylland, May 2, 2007, p. 8.
[131] United States District Court, District of South Dakota, Southern Division, Securities and Exchange Commission, Plaintiff, v. Richard R. Hylland, Defendant, Complaint, April 25, 2007, pp. 22-23.

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status.[132] In downgrading the bond ratings, the rating agencies made the following comments regarding NorthWestern's prospects:

- "The rating action is the culmination of the continued problems associated with the company's Expanets Inc. and Blue Dot Inc. subsidiaries, resulting in an $890 million write-off and also resulting in anemic funds from operation interest coverage ratios for the next several years…Even though NorthWestern intends to divest or dispose of its noncore assets, Standard & Poor's is also concerned about management's ability to execute this plan in a timely manner. Funds from operations in the fourth quarter were significantly lower than management had previously forecasted."[133]
- "The restatement of 2002 audited financial results and impairment charges on Bluedot and Expanets demonstrates the inability of these businesses to generate positive cash flow. Even though the charges are largely a non-cash event, the $890 million of impairment charges completely eliminated the equity layer of the consolidated corporation and mean that the company will never recover the recorded goodwill and its investment. The impairment charge further implies a sale of the assets will probably not generate significant cash."[134]
- "The company's liquidity is tight primarily because of its seriously constrained financial flexibility. The company has no access to the public equity market; the only other means of generating cash is an expected sale for $97 million of the Colstrip transmission assets, which are currently in litigation with PPL Corp., and the sale of the Montana First Megawatt…"[135]
- "In addition to our expectation that funds from operations will continue to be meager in relation to total debt, Moody's does not see a likelihood of substantial reduction of the company's heavy debt burden in the near term, either by the sale of nonutility assets or through the issuance of equity. This view considers that nonutility assets have exhibited very poor returns… The company's leveraged balance sheet and weak cash flow coverage of fixed charges, which we expect to be below 2x for 2003, leaves investors without any visible cushion for further unexpected adverse events."[136]
- "Given the magnitude of the year-end 2002 asset writedowns and the disclosure of operational deficiencies at Expanets, Fitch believes that it will be less likely that NOR will generate material net cash proceeds from the sale of its non-regulated investments. Although the performance of NOR's electric and gas utility division

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[132] See Exhibit 4.
[133] Standard & Poor's press release: NorthWestern Corp. Rating Lowered, Still on CreditWatch Negative, April 21, 2003 (NOR034685-86).
[134] Standard & Poor's Research Update, NorthWestern Corp. May 23, 2003, p. 2.
[135] Standard & Poor's press release: Northwestern Preferred Stock Rating Lowered to 'C', Still on Watch Neg. May 23, 2003 (NOR034841).
[136] Moody's Investor Services, Global Credit Research Rating Action, Moody's Downgrades Ratings of NorthWestern Corporation (Sr. Sec. To B2); Rating Outlook is Negative, April 25, 2003.

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should remain stable, consolidated credit protection measures will remain extremely weak for the foreseeable future absent meaningful reduction in NOR's debt load."[137]

- "The funding of a $390 million secured term loan in February 2003 has stabilized NOR's near-term liquidity position... However, the amount of asset protection available to senior unsecured bondholders has been meaningfully reduced as a result of the new secured facility. NOR's utility division fixed assets currently carry a book value of approximately $1.7 billion. Total first mortgage bonds currently issued approximate $860 million thus leaving potential residual utility asset value available for senior unsecured creditors of about $750 million versus year-end 2002 unsecured debt outstanding of approximately $1 billion."[138]

66. Finally, while most equity analysts had tellingly stopped covering the Company, one that still provided coverage reported:

> As expected, NorthWestern reported significant losses for 2002. Excluding the impact of unusual items, we arrive at a loss of $2.70 per share in 2002. We expect continued losses over our forecast period. Based on our financial forecast, we have concerns over the viability of NorthWestern as a going concern. Specifically, we believe that cash generated from the utility business may not be sufficient to cover interest costs, preferred securities obligations and maintenance capital expenditures.[139]

Financial restatement per Accounting Expert

67. In addition to the adjustments reported in the restated quarterly filings, Mr. Berliner has analyzed the accounting records and the SEC filings and made additional adjustments. A summary of these adjusted financial statements is attached as Exhibit 6. I have used on the adjustments made by Mr. Berliner in performing certain analyses which support my opinion.

68. The analysis of Mr. Berliner indicates that $390 million of the impairment charge that was ultimately taken in the fourth quarter of 2002 (reported on April 15, 2003 in the Company's 10-K) should have been taken as of June 30, 2002.[140]

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[137] Fitch press release: Fitch Ratings Lowers NorthWestern's Senior Unsec To 'B+'; Rating Outlook Negative, April 23, 2003.
[138] Fitch press release: Fitch Ratings Lowers NorthWestern's Senior Unsec To 'B+'; Rating Outlook Negative, April 23, 2003.
[139] RBC Capital Markets Research Comment, NorthWestern Corporation, Review of Annual Report Raises Concerns Over Viability of a Company as A, April 17, 2003.
[140] See Exhibit 6.

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69. I have also used Mr. Berliner's calculation of the financial covenants related to the CSFB $280 million revolver. His calculations show that NorthWestern's net worth was $289.1 million as of June 30, 2002 and $198.9 million as of September 30, 2002.[141] As the credit agreement states that NorthWestern must have net worth of $350 million at a minimum,[142] NorthWestern would have been in violation of this covenant as of these dates. Mr. Berliner also calculated the funded debt to total capital ratio which equaled 83.5% as of June 30, 2002 and 85.1% as of September 30, 2002.[143] NorthWestern would have then also been in violation of the funded debt to total capital covenant as of these dates as the ratio must not exceed 72%.[144]

[141] Expert Report of Robert W. Berliner, CPA, CFE, September 19, 2007, Attachments A-1and A-2 to the Basis for Opinion 4.
[142] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), p. 63.
[143] Expert Report of Robert W. Berliner, CPA, CFE, September 19, 2007, Attachments A-3 and A-4 to the Basis for Opinion 4.
[144] NorthWestern Form 10-Q for the period June 30, 2002 filed August 14, 2002, Exhibit 10.1, Amendment No. 2 to Credit Agreement, p. 1.

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Statement of Opinions

70. My opinions in this matter are:

I. The misstatements and omissions in NorthWestern's financial statements, Registration Statement in connection with the $720 million in bonds, and other public disclosures during 2002 enabled the Company to complete the October 2002 $87 million equity offering and the transfer of the NorthWestern Energy L.L.C. assets to NorthWestern in November 2002. Had the true information been disclosed to the public prior to October 8 and November 15, 2002, respectively, the equity offering would not have occurred and the asset transfer would have been impeded by the attempts of security holders and regulators to protect their respective investments and constituents because:

- **The market's knowledge that NorthWestern would never realize a return on or cash flow from its significant investment (including preferred stock and intercompany advances) in its unregulated subsidiaries, Blue Dot and Expanets, would have been accelerated.**
- **The precipitous drop in NorthWestern's stock price would have been accelerated.**
- **The downgrading of NorthWestern's credit to below investment grade would have been accelerated.**
- **NorthWestern would have defaulted on financial covenants related to its $280 million facility for which Credit Suisse First Boston ("CSFB") was the administrative agent.[145]**
- **CSFB would likely not have funded the $280 million facility.**
- **The suspension of NorthWestern's dividend would have been accelerated.**
- **The $390 million debt financing with CSFB would have been unlikely.**

71. Even prior to the ultimate announcement of the Company's true problems, NorthWestern was aware of the difficulties and negative financial impact of issuing the upwards of $200 million of equity that the credit rating agencies and regulators were expecting,[146] its bond ratings were continually being reviewed for downgrades,[147] and

[145] Depending on context, CSFB refers to itself and other members of the bank group.
[146] Bear Stearns Presentation to NorthWestern Corporation Board of Directors, September 27, 2002, p. 6 (NOR255876). Moody's Investor Services, Global Credit Research Rating Action, Moody's Assigns Baa2 Rating to NorthWestern Corporation's Planned $700 million Note Offering, March 5, 2002. Moody's Press Release: Moody's Places Credit Ratings of NorthWestern Corporation and its Subsidiary NorthWestern Energy, L.L.C. Under Review for Possible Downgrade (Sr. Sec. At Baa1), August 1, 2002 (NOR076208). Standard and Poor's Press Release: NorthWestern Corp.'s Corporate Credit Rating Lowered to 'BB+'; Outlook Remains Negative, December 30, 2002 (NOR058328-32).

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its liquidity was drying up.[148] As the true or previously concealed information was revealed over time, NorthWestern was forced to cut its cash dividend payments, saw its stock price plummet, lost its investment grade rating and ultimately declared bankruptcy. Had the information about the Company's problems, which were eventually made known to the marketplace (during press releases and financial disclosures from September 20, 2002 through April 15, 2003) been properly disclosed prior to November 15, 2002, a similar pattern of events, albeit at an earlier point in time, should be expected.

72. As discussed above, if the financial markets had access to accurate financial statements for the first three quarters of 2002 and if they had known that the Company would incur a significant write-off due to the impairment of Expanets and Blue Dot in June 2002 and that the approximately $140 million of EBITDA[149] that those subsidiaries were predicting for 2003 would be well below expectations causing the Company's expected future cash flow to be greatly reduced, the following would have been the immediate impacts:

a) The rating agencies would have likely downgraded the Company's debt during the first quarter of 2002 and in subsequent quarters. It is also likely that in reaction to the second quarter results, the ratings agencies at minimum would have downgraded NorthWestern's unsecured debt to below investment grade.

b) The Company's stock price would have fallen each quarter based on the significantly more pessimistic view of the Company's future prospects.

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[147] Moody's Investor Services, Global Credit Research Rating Action, Moody's Downgrades Ratings of NorthWestern Corporation (Sr. Sec. To Baa3); Continues to Review Ratings for Possible Further Downgrade, December 20, 2002. Email from C. Thomson to J. Finch and D. Welch Re: Moody's Press Release, November 20, 2001 (CSFB010284-85). Fitch press release: NorthWestern Corp's $720MM Sr Notes Rated 'BBB+' By Fitch Ratings, March 8, 2002. Moody's Press Release: Moody's Places Credit Ratings of NorthWestern Corporation and its Subsidiary NorthWestern Energy, L.L.C. Under Review for Possible Downgrade (Sr. Sec. At Baa1), August 1, 2002 (NOR076208).

[148] Jacobsen Exhibit 7, Memo from K. Orme to M. Lewis, D. Hylland and E. Jacobsen Re: Financing Plans and Considerations, May 28, 2002 (NOR056238).

[149] Bear Stearns Presentation to NorthWestern Corporation, September 20, 2002, p. 3 (NOR057789). NorthWestern Corporation's Second Quarter Earnings Release conference call transcript, August 8, 2002, p. 15 (NOR099947).

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c) The Company would have breached the $350 million minimum net worth covenant and exceeded the funded debt to total capital covenant of 72% under its $280 million CSFB credit agreement[150] during the second and third quarters of 2002.[151]

73. As a result of these initial reactions to the release of accurate and truthful financial information, NorthWestern's prospects would have continued to diminish as its financial difficulties, in particular a shortage of cash, would have ultimately led to continued downgrades of its debt, no access to the conventional capital markets for debt or equity financing and the elimination of the Company's dividend. With all of the events occurring somewhat simultaneously in the capital markets (i.e., the release of negatively revised operation performance, ratings downgrades, dropping stock price, need to write-off Expanets and Blue Dot, and debt covenant defaults), the Company's overall financial profile would have been so bad that it would have been unlikely that it could have found a sizable enough source of capital to prevent the eventual bankruptcy filing that actually occurred.

74. Below, I have attempted to discuss each of the relevant factors, beginning with the three listed above, which would have contributed to NorthWestern's precarious financial position prior to November 15, 2002 had all the relevant information been disclosed. While I address them independently, they are frequently interrelated.

Ratings downgrade

75. Though the credit ratings for NorthWestern and its secured and unsecured debt were investment grade throughout 2002, a comparison of NorthWestern's financial ratios similar to ratios utilized by S&P to rate utility companies demonstrates that NorthWestern's ratios were indicative of a company with generally lower credit quality. Several mitigating conditions were relied upon by the rating agency to support the higher quality ratings including but not limited to: (1) the planned $200 million equity

[150] NorthWestern Form 10-Q for the period June 30, 2002 filed August 14, 2002, Exhibit 10.1, Amendment No. 2 to Credit Agreement, p. 1.
[151] Expert Report of Robert W. Berliner, CPA, CFE, September 19, 2007, Attachments A-1, A-2, A-3, and A-4 to the Basis for Opinion 4.

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offering, (2) the transfer of NorthWestern Energy, L.L.C.'s assets to the parent level, and (3) a significant turnaround in the performance of the unregulated subsidiaries.[152]

76. As shown in Exhibit 7, using NorthWestern's restated financials (both Company restated as well as the revised restatements calculated by Mr. Berliner), the above mentioned financial ratios would have firmly indicated a below investment grade credit rating for NorthWestern beginning as early as the first quarter of 2002. To make this determination, I compared the credit ratings indicated by the ratios that NorthWestern would have had throughout 2002 if the true financials had been available to a selection of key utility financial ratios that were defined by S&P in its 2002 Corporate Ratings Criteria report.[153] The results of this comparison combined with the elimination of the above mentioned mitigating factors due to the appropriate disclosures, would have likely caused the Company's corporate and unsecured debt ratings, and its secured debt rating shortly thereafter, to drop to below investment grade.

77. Throughout this period, NorthWestern management understood both the importance of its credit ratings to its ability to obtain debt and equity financing and of its reported income (and the future prospects that are inferred by the reported income) to the determination of those ratings by the agencies. Specifically, as will be discussed, a below investment grade rating would have greatly impaired its ability to issue equity, pay quarterly cash dividends, and draw funds under the $280 million revolver, as well as significantly increased its interest expense.

NorthWestern stock price drop

78. Based on my review of available analyst coverage of NorthWestern, a number of issues were identified as contributing to the market's analysis of NorthWestern's future prospects and ultimately its stock price. These factors include but are not limited to

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[152] Moody's Investor Services, Global Credit Research Rating Action, Moody's Assigns Baa2 Rating to NorthWestern Corporation's Planned $700 million Note Offering, March 5, 2002. Moody's Press Release: Moody's Places Credit Ratings of NorthWestern Corporation and its Subsidiary NorthWestern Energy, L.L.C. Under Review for Possible Downgrade (Sr. Sec. At Baa1), August 1, 2002 (NOR076208). Standard and Poor's Press Release: NorthWestern Corp.'s Corporate Credit Rating Lowered to 'BB+'; Outlook Remains Negative, December 30, 2002 (NOR058328-32). Fitch press release: Fitch Dwngr NorthWestern Corp Sr Sec To 'BBB+'; Outlook Negative, October 14, 2002. E-mail from C. Thomson to J. Finch and D. Welch Re: Moody's Press Release, November 20, 2001 (CSFB010284-85).

[153] S&P 2002 Corporate Ratings Criteria report, pp. 54-55.

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leverage, liquidity, operating performance of its utility and unregulated subsidiaries, and the ability to pay dividends.

79. The following events are excerpted from the table in the Background section with the closing stock price on the day of the various actual events indicated. All else being equal, I would expect that a similar trend in the Company's stock price would generally have coincided with the actual disclosure of the information that was previously false or omitted. Regardless of the exact timing, it is reasonable to believe that had the market received all of the relevant information prior to November 15, 2002, it would have severely penalized the Company's stock price prior to that time. Given the content of e-mails and other documents, it is apparent that senior management had a similar understanding about what the market reaction would be and determined not to share the information.[154] Please refer to Exhibit 3 for a more complete diagram of the fluctuations during the relevant period in NorthWestern's stock price.

Event	Closing price[155]
February 15, 2002 NorthWestern acquired Montana Power.	$21.60
August 8, 2002 NorthWestern reaffirmed $2.30 -$2.55 EPS target for 2002.	$12.30
September 20, 2002 NorthWestern filed amended 10-Q's for the first and second quarters of 2002.	$10.00
October 8, 2002 NorthWestern completed common stock offering.	$7.48
November 7, 2002 NorthWestern lowered its EPS target for 2002 to $1.50 -$1.60.	$7.88
December 13, 2002 NorthWestern announced that it would miss its EPS targets and potential of goodwill impairment.	$5.00
April 15, 2003 NorthWestern filed its 2002 10-K and restated the first three quarters of 2002.	$2.27

Covenant default

80. The CSFB $280 million credit facility, which was in place from January 14, 2002[156] until its repayment on February 10, 2003,[157] included financial covenants. The violation of

[154] Memo from K. Orme to M. Lewis, D. Hylland and E. Jacobsen, Re: *Financing Plans & Considerations*, May 5, 2002, pp. 3-5 (NOR056240-42).
[155] Bloomberg stock quote data

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any of these covenants would have been considered an Event of Default and would have given CSFB the authority to cease funding the credit facility, demand payment of the full outstanding amount of the loan[158] or prohibit NorthWestern from paying cash dividends.[159]

81. The violation of a financial covenant is a significant negative signal to the market as it is an indication of a company's failing financial health. These covenants, which are typically set with cushion to give a company operating flexibility, are in place to protect lenders from a company with deteriorating financial performance. By setting these covenants at points where the lender believes that the company could still repay its loan, the lender can force the borrower to the negotiating table to allow for a satisfactory restructuring if necessary. Since the ramifications of covenant defaults can include the acceleration of existing loans or the prohibition on new funding, the existence of a default is material to the capital market's assessment of a company's financial status. At its extreme, a covenant default can call into question a company's ability to function as a going concern.

82. The three covenants were:

- Minimum net worth of the company must be at least $350 million on the last day of any fiscal quarter.[160]
- The funded debt to total capital ratio must not exceed 72% on the last day of any fiscal quarter prior to the termination date.[161]
- The utility business EBITDA to consolidated recourse interest expense ratio on the last day of any fiscal period must not be less than 2 to 1.[162]

83. Based on the covenant calculations provided by Mr. Berliner, beginning June 30, 2002 and continuing through the year, NorthWestern's net worth would have been below $350.[163] Additionally, NorthWestern's funded debt to total capital ratio would have

[156] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), p. 1.
[157] NorthWestern Form 10-K for the period December 31, 2002 filed April 15, 2003, p. 61.
[158] Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), pp. 63, 70, 72.
[159] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), pp. 66-67.
[160] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), p. 63.
[161] NorthWestern Form 10-Q for the period June 30, 2002 filed August 14, 2002, Exhibit 10.1, Amendment No. 2 to Credit Agreement, p. 1.
[162] NorthWestern Form 10-Q for the period June 30, 2002 filed August 14, 2002, Exhibit 10.1, Amendment No. 2 to Credit Agreement, p. 2.
[163] Expert Report of Robert W. Berliner, CPA, CFE, September 19, 2007, Attachments A-1 and A-2 to the Basis for Opinion 4.

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exceeded 72% during the same period.[164] NorthWestern would therefore have been in violation of its minimum net worth and funded debt to total capital ratio covenants during that period and subject to the consequences of those violations, which I discuss below.

Funding of CSFB $280 million credit facility

84. Given the covenant default, one of the first financing issues that the Company would have faced is the funding of the CSFB $280 million revolving credit facility.[165] As calculated by Mr. Berliner, NorthWestern would have been in violation of two financial covenants at that time.

85. The default would have given a majority of the bank group the right to terminate their commitment or accelerate their loans,[166] which all else being equal would have, put NorthWestern into a negative cash position in the next quarter when it had debt repayments of over $150 million coming due.[167] As of June 30, 2002, NorthWestern's cash balance was approximately $80 million and during the third quarter, operations generated only $3 million in cash.[168] With few if any sources of additional funds, NorthWestern would not have been able to make the debt repayments if CSFB did not provide the funds. The outstanding amount borrowed under the revolver increased from $0 at the end of the second quarter[169] to $231 million at the end of the third quarter,[170] because, among other things, NorthWestern used draws on the revolver to pay off the debt that matured in September. Specifically, as of August 7, 2002, the balance on the revolver was $35 million with $11.7 million in letters of credit outstanding.[171] As of September 9, 2002, the balance was $68 million with $19.6

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[164] Expert Report of Robert W. Berliner, CPA, CFE, September 19, 2007, Attachments A-3 and A-4 to the Basis for Opinion 4.
[165] NorthWestern Form 10-Q for the period June 30, 2002 filed August 14, 2002, p. 29.
[166] NorthWestern Form 10-K405 for the period December 31, 2001 filed April 1, 2002, Exhibit 10(b)(1), p. 72.
[167] NorthWestern Form 10-Q/A for the period June 30, 2002 filed April 15, 2003, pp. 49-53. NorthWestern Form 10-Q/A for the period September 30, 2002 filed April 15, 2003, pp. 52-53.
[168] NorthWestern Form 10-Q for the period June 30, 2002 filed August 14, 2002, Consolidated Statement of Cash Flows, pp. 4-5. NorthWestern Form 10-Q for the period September 30, 2002 filed November 14, 2002, Consolidated Statement of Cash Flows, pp. 4-5.
[169] NorthWestern Form 10-Q/A for the period June 30, 2002 filed April 15, 2003, pp. 49-53.
[170] NorthWestern Form 10-Q/A for the period September 30, 2002 filed April 15, 2003, p. 52.
[171] NorthWestern Form 10-Q for the period June 30, 2002 filed August 14, 2002, p. 29.

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million in letters of credit outstanding,[172] and the balance increased to $231 million by the end of the month.

86. Additionally, because NorthWestern had not drawn on the CSFB facility at the end of the second quarter, CSFB would have been well positioned not to fund when the truth about NorthWestern's financially stressed situation was disclosed.

$87 million equity offering

87. The market's realization that the Company's future prospects were significantly worse due to the proper disclosure of information, combined with the likely negative reaction of the rating agencies and the stock price, and the defaulted status of its only present accessible source of credit financing (the CSFB credit facility) would have had a significant negative effect on the Company's ability to raise equity.

88. First, the maintenance of an investment grade credit rating was a condition of the underwriting agreement.[173] Independent of that agreement, the need for the Company to maintain its credit rating as an important factor in raising equity was also acknowledged by NorthWestern management: "Q. So to the extent NorthWestern wanted to close on the equity offering, it was important for the rating not to change, correct? A. That's one factor, yes."[174]

89. Second, as a result of its "junk bond" status and covenant default, the Company would have been unappealing to the debt markets; therefore, the equity markets (which rely on utility companies' ability to obtain large amounts of debt capital to fund themselves) would have been uninterested in investing in NorthWestern due to its nearly illiquid position.

90. Third, there was a high likelihood that the Company's stock price would have dropped significantly due the market's revised expectations regarding NorthWestern's future prospects causing an equity offering to be prohibitively dilutive and costly. As two quarters of consolidated EBITDA falling well below expectations would have been

[172] NorthWestern Form 10-Q/A for the period June 30, 2002 filed September 20, 2002, p. 38.
[173] NorthWestern Form 8-K for the period October 2, 2002 filed October 8, 2002, Exhibit 1.1, p. 12.
[174] Deposition of Eric Jacobsen, June 19, 2007, p. 155.

released by October 2002, as well as negative EBITDA at Expanets and the other disclosures described above,[175] and according to Mr. Berliner, a portion of the impairment would been recorded in the second quarter, a decline, similar to the one that actually occurred, in the Company's stock price would have occurred by October 2002. As the SEC stated, "NorthWestern recognized that improvement in the performance of both Expanets and Blue Dot was critical to its planned equity offering."[176]

91. These factors combined with the fact that the equity markets were increasingly tight throughout 2002, particularly for utilities, and not receptive to companies with high leverage and negative operating trends lead to the conclusion that the Company would have been unable to complete the October 2002 equity offering that raised $81 million in net proceeds.

92. With public equity financing ruled out as a reasonable financing alternative, NorthWestern would have considered private equity as an option to raise capital. However, the Company had endeavored to raise funds privately in September 2002 but was unable to complete this type of transaction as discussed by Bear Stearns: "Evercore [private equity firm] has completed its diligence efforts and has decided that it is not comfortable with a $200M investment… Primary reasons were: Structural concerns (secured vs. unsecured nature of investment) coupled with lack of visibility at Expanets".[177] These concerns were expressed prior to disclosure of the restated and omitted information. Visibility would have only increased Evercore's concerns.

93. Additionally, the $87 million equity offering that was completed was insufficient for the ratings agencies and for the equity analysts to change their negative opinions about the Company and was completed under false pretenses. The $8.75 share price[178] was troubling to the market as described in the following: "The company has previously indicated that it plans to issue approximately $200 million in new equity to strengthen

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[175] NorthWestern Form 10-Q for the period March 31, 2002 filed April 15, 2003, p. 17. NorthWestern Form 10-Q for the period June 30, 2002 filed April 15, 2003, p. 23.
[176] Securities and Exchange Commission, Order Instituting Cease-and-Desist Proceedings, Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, March 7, 2007, p. 3.
[177] Bear Stearns Presentation to NorthWestern Corporation, September 20, 2002, p. 1 (NOR057787).
[178] NorthWestern Form 8-K for the period October 2, 2002 filed October 8, 2002, Exhibit 1.1, Schedule B.